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Testimony

of the

National Grain and Feed Association

Before the

Subcommittee on General Farm Commodities and Risk Management

House Agriculture Committee

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Chairman Moran and members of the Subcommittee, I am John Fletcher, general manager of Central Missouri AGRIService Inc., in Marshall, Mo. Our company is a joint venture between a family owned company and two cooperatives. CMAS operates our country elevator, farm supply and feed manufacturing business in west central Missouri. We were established in our present form in 1999. We currently operate six country elevators and two feed mills. I am testifying today on behalf of the National Grain and Feed Association, on whose Country Elevator Committee and Board of Directors I serve.

The NGFA is comprised of 900 grain, feed, processing, exporting and other grain-related companies that operate about 6,000 facilities that handle more than 70 percent of all U.S. grains and oilseeds. The NGFA's membership encompasses all sectors of the industry, including country, terminal and export elevators; feed manufacturers; cash grain and feed merchants; end users of grain and grain products, including processors, flour millers, and livestock and poultry integrators; commodity futures brokers and commission merchants; and allied industries. The NGFA also consists of 35 affiliated state and regional grain and feed associations, as well as two international affiliated associations. The NGFA has strategic alliances with the Pet Food Institute and the Grain Elevator and Processing Society, and has a joint operating and services agreement with the North American Export Grain Association (NAEGA).

The NGFA appreciates the opportunity to testify today to provide our perspective on the U.S. Department of Agriculture's procedures for establishing posted county prices (PCPs) under the marketing assistance loan program. In addition, we want to offer some thoughts in preparation for the 2007 farm bill about what we believe is a need for USDA to update its beneficial interest procedures to be more accommodating of the types of cash grain contracts currently being offered to optimize the potential for producers to earn more income from the marketplace.

Posted County Prices

At the outset, we believe it is important to note that the PCP system was developed by USDA in 1983 in conjunction with the 1983 payment-in-kind program as a method for establishing baseline values for Commodity Credit Corporation-owned inventory and price support loan collateral. Prior to that, USDA had utilized posted elevator prices as a mechanism for establishing values for CCC-owned inventory. During these early years of the PCP system, USDA's goal was to price CCC-owned inventory as close to the market as possible so that it did not undersell or oversell. As a method of approximating grain price values in specific geographic areas, the PCP system performed remarkably well – enabling USDA starting in 1985 to liquidate in an efficient and orderly manner CCC's extensive grain inventory with minimal market disruption.

But during subsequent farm bills – particularly the Federal Agriculture Improvement and Reform Act of 1996 – Congress gave USDA different marching orders by adopting a marketing loan program for wheat, feedgrains, soybeans, minor oilseeds, cotton and rice. The laudable goal was to support farm income while allowing grain to be priced at market-clearing levels to avoid another buildup of government-owned stocks that overhang the market and depress farmgate prices. Specifically, the 1996 farm law directed CCC "to the extent possible" to determine and announce an alternative repayment rate, based upon the previous day's market price at appropriate U.S. terminal markets as determined by CCC, adjusted to reflect quality and location for each commodity. It was this statutory language that USDA used as the rationale for shifting its PCP system to a new, expanded and much more complex role – using it to determine commodity price values as close as possible to the local cash market price in any given area as a key component of an income-transfer mechanism.

In early 1999, the NGFA provided a series of comprehensive recommendations to USDA on ways to improve its system for determining PCPs. Among other things, we recommended that USDA reevaluate the terminal markets it was using, as well as the differentials, to enable PCPs to more accurately reflect local market prices. The NGFA also recommended that USDA revise and update county loan rates for wheat and feed grains to reflect the most recent 12-month average of market prices, and to establish wheat loan rates by class. Further, we recommended that USDA base the LDP loan rate on the county where the commodity is produced, not where delivered or stored, and to permit a 30-day grace period for producers to select their LDP payment to provide additional flexibility and to accommodate logistical concerns.

We commend the Bush administration for utilizing the authority provided in the 2002 farm law to act on several of these recommendations. Most significantly, USDA used congressional intent expressed in report language accompanying the 2002 farm law to update county loan rates and established wheat loan rates by class – the first such adjustments since the 1995 crop, which were based on 1993- and 1994-crop posted county prices that were themselves deemed to be in need of substantial revision to better reflect local market prices.

It was in 2002 that USDA also implemented loan deficiency payment rates on a statewide basis, in response to the 2002 farm law's provision that required USDA when setting loan repayment rates under both the marketing loan and loan deficiency payment program to "minimize discrepancies in marketing loan benefits across state…and county boundaries."

So, where do we stand today?

On a **national** basis, our sense is that USDA generally did a good job this year of monitoring and adjusting its PCPs to keep them roughly in line with cash market prices in local areas during a very difficult harvest situation complicated by large crops, hurricane disruptions and rapidly escalating freight rates. Unlike some previous years, the NGFA's office generally received a lower volume of calls and complaints about PCP anomalies than we had in some previous years.

However, there certainly were some exceptions:

- In mid-October, several NGFA-member country elevators began reporting that sorghum PCPs were no longer reflecting local cash market prices in several areas in Kansas.

- In my home state of Missouri, the gap between PCPs and local elevator cash prices were significantly wider this year during the peak of harvest compared to previous years. For instance, in some areas of Missouri, there was a 20- to 30-cent price differential between county PCP prices and local elevator prices on corn, although local soybean cash prices generally remained above PCPs. However, it appears that much of the differential disappeared in the post-harvest period, which leads us to believe that the spike in harvest transportation costs attributable to extremely tight transportation capacity constraints and the disruption caused by Hurricanes Katrina and Rita played a direct role.

- In the Pacific Northwest, producers and elevators in all counties producing white wheat are facing a problem more attributable to loan rates than PCPs. One of our country elevator members in Washington state reports that the current loan rates for the different wheat classes range from $2.74 per bushel for soft white wheat to $3.24 per bushel for hard red winter and $3.40 per bushel for dark northern spring. But the countercyclical payment rates are based on a compilation of all wheat classes, not individual classes. Recent market prices at that country elevator location have been $2.96 per bushel for soft white, $4.05 per bushel for hard red winter and $4.69 per bushel for dark northern spring, so countercyclical payments are not expected to come into play this year. But the loan rate differentials between these wheat classes are encouraging producers to plant hard red winter to maximize both price support and market benefits, even though the region is not conducive to producing good-quality wheat of that class. Loan rates that are inconsistent with current cash market values cause longer-term market distortions, including misguided planting decisions and impacts on local land values.

How could the current PCP system be improved to more accurately reflect local markets on a consistent basis?

For starters, we believe that dramatically improving the current system would require a substantial increase in the market-price sampling points that USDA contacts daily, to include more localized markets. One of the real challenges in this regard is the trend in markets away from terminal market-based pricing, as many grain movements occur directly from the origin elevator to the customer, bypassing traditional terminal points in the process. This makes local market prices much less predictable unless individual local markets are monitored daily, which would be a huge undertaking. The proliferation of such destination markets as ethanol and biodiesel plants has further complicated USDA's PCP price-monitoring process.

In addition, USDA would need to devise a system that more adequately incorporates changes in transportation costs to reflect actual freight rates for rail, barge and truck or actual freight costs to specific market destinations. It is our view that USDA's terminal market "differentials" relied upon to determine PCPs in local areas are not truly reflecting the freight value changes we are seeing regularly in the market. But these freight rates can fluctuate dramatically, particularly given the impact of carrier-imposed fuel surcharges, which can vary monthly.

The bottom line is that the current system used by USDA – given the human and financial resources allocated to it – is doing about as well as can be expected. As noted previously, to do more to proactively address PCP anomalies that can emerge or occur or when seasonal distortions come into play would require that USDA invest a much higher level of both human and financial resources to monitor local cash prices – a degree of monitoring that we're not sure either the administration or Congress would be willing to undertake.

Currently, USDA relies on producers, grain elevator operators and market observers to provide assistance in alerting the department if PCPs are out-of-line with local cash markets in certain geographic areas. At times, the NGFA itself has been alerted to such PCP anomalies by its members, and has notified USDA headquarters. Generally, our experience has been that these reports are investigated quickly and efficiently by USDA, and that the department is responsive to addressing and correcting significant anomalies that, based upon followup investigation, are shown to warrant adjustment. However, we also have received reports from some NGFA-member companies expressing frustration with the USDA Kansas City Commodity Office's responsiveness after reporting PCP anomalies. To rectify this, the NGFA suggests that USDA establish a more transparent, systematic and better-defined method – perhaps a web-based program – for reporting instances in the future when the LDP payment plus the local cash price is out-of-line with the loan rate. We also believe USDA could be more transparent in explaining the general parameters it uses to investigate PCP anomalies and the factors it uses to determine whether adjustments are warranted. USDA also could improve its follow-up with those who report such anomalies to explain the results of USDA's investigation and the reasons for any adjustments – or lack thereof – that subsequently are made. However, the NGFA does believe that USDA is in the best position to resolve these anomalies in a prudent and expeditious manner.

Beneficial Interest

The NGFA also wishes to take this opportunity to encourage USDA to revisit one other component of the marketing assistance loan program that has been problematic in restricting the ability of producers to utilize modern risk-management tools when contracting to sell grains and oilseeds.

I am referring to the requirement that producers retain "beneficial interest" – that is, title, control and risk of loss – in the commodity to be eligible to receive a loan deficiency payment (LDP) or marketing loan gain.

We commend USDA for earlier this year making several improvements to certain procedural aspects of its beneficial interest rules. In April, USDA's Farm Service Agency issued a notice that clarified that beneficial interest in a commodity is retained until such time as the producer makes a marketing decision with respect to the commodity or relinquishes beneficial interest under the terms and conditions of an applicable written or verbal contract. This helped clarify that producers placing grain in "open storage" at grain elevators did not lose beneficial interest because they still retained the ability to market their crops.

Then in August, USDA developed a new, simplified form that producers can use to indicate their intent to receive an LDP before losing beneficial interest. This new CCC-633 EZ form enables producers to indicate once each crop year of their intention to receive an LDP. This form then allows the producer to subsequently submit a request for the LDP at any time during the marketing assistance loan or LDP availability period for the given commodity. The LDP rate for the affected commodity is based on the earlier of: 1) the date the producer requests the payment; or 2) the date beneficial interest is or was lost.

While both of these steps have improved the "mechanics" of the marketing assistance loan process with respect to beneficial interest, they have not resolved the major underlying problem. And that problem is that the concept of beneficial interest is out-of-kilter with various kinds of new-generation cash grain contracts that offer producers opportunities to maximize market returns. Specifically, USDA has ruled that certain types of advance sales contracts, contracts-to-sell, price-later contracts and contracts for future delivery of grain violate the "beneficial interest" rules because these contracts give the buyer an interest in the commodity at the time specified in the contract or at a time implied by law.

For example, USDA has stated that: "…If the producer has or will receive a payment in return for a sales contract, 'beneficial interest' is lost when the payment is made or when the producer loses control, risk of loss, or title to the commodity….In a credit-sale contract, such as a delayed-price or deferred-payment contract, legal title and physical possession of the commodity have transferred. Thus, the producer has lost 'beneficial interest' for the quantity sold under such contracts." *[**NGFA Government and Grain**, September 30, 2004.]*

The NGFA respectfully submits that there is something amiss when a government farm program that is designed to avert forfeitures, encourage stocks to enter market channels, and maximize farm income has the unintended and perverse effect of limiting the marketing options available to producers.

The NGFA believes USDA has the legal authority under current statutory language to revisit the beneficial interest issue to bring it more into line with the current market environment and the type of producer marketing contracts currently being offered, while still preserving proper safeguards to prevent fraud, abuse or "price speculation" by producers attempting to maximize LDP benefits. Allowing producers to enter into a full array of cash grain contracts earlier in the crop year could improve their ability to generate additional revenue from the market and further strengthen the producer safety net.

If USDA's analysis reveals that it does not believe it has sufficient statutory authority to modify its current interpretation of the beneficial interest rules, the NGFA may seek Congress' help in revising the statute as part of the 2007 farm bill.

Mr. Chairman, that concludes my statement. I would be pleased to respond to any questions you or other members of the Subcommittee may have.